

Investment Office Annual Plan

Mark Anson
Chief Investment Officer
CalPERS

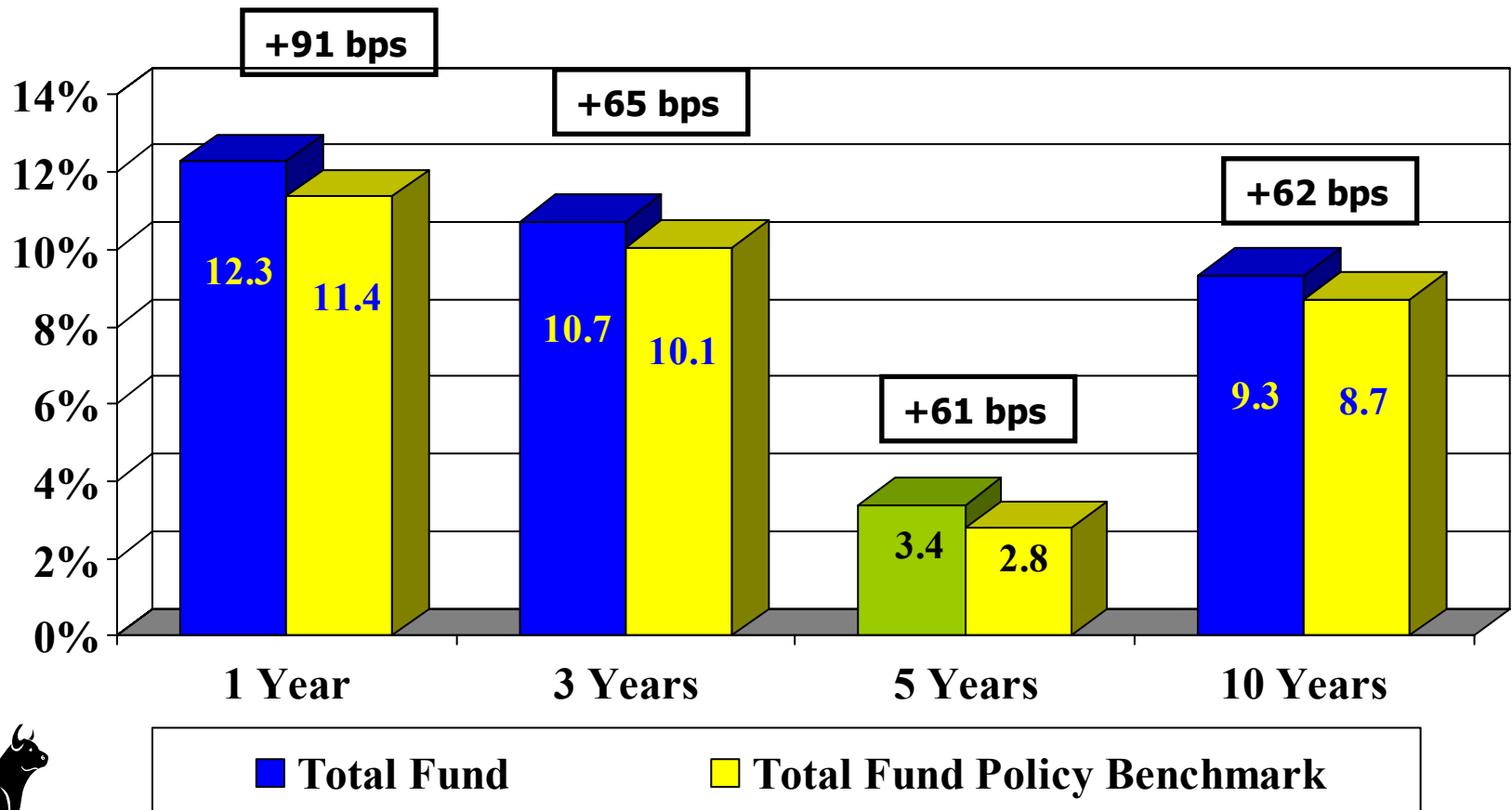


Performance

- CEM, an independent review service has determined that the Investment Staff has generated \$13.7 billion of value added to the CalPERS' portfolio over the last 10 years.
- The Fund has out performed its benchmark on a 1, 3, 5 and 10 year basis.
- Out performance of this magnitude over this long a time period is a demonstration of skill, not luck.



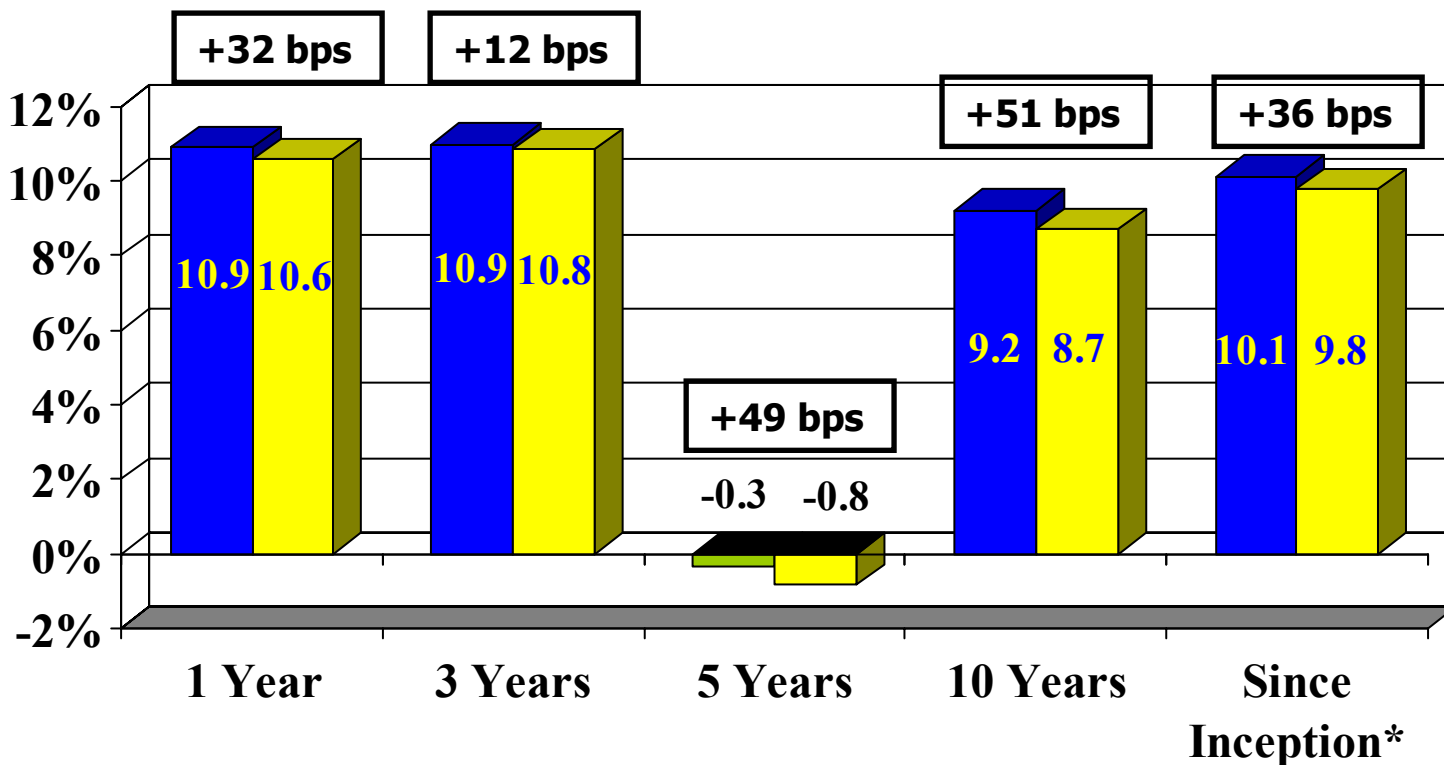
Total Fund Annualized Active Return in Basis Points as of 6/30/05 (Current Assets of \$189.9 Billion)



CFA Institute compliant. Net of fees. As measured by CEM, cumulative added value over the past 10 years is \$13.7 billion.



Global Equity Annualized Active Return in Basis Points as of 6/30/05 (Current Assets of \$117.7 Billion)



■ Total Global Equity

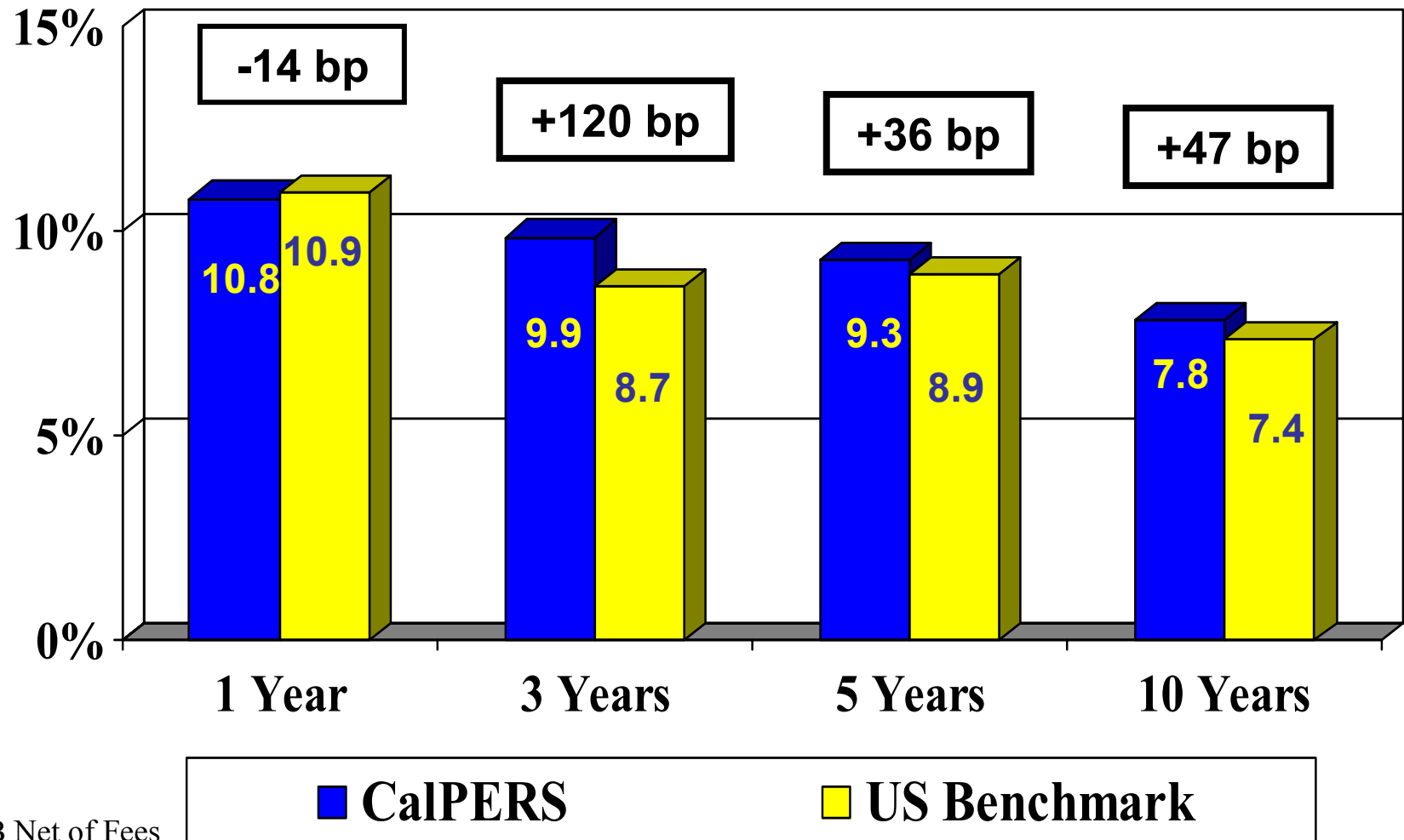
■ Total Global Equity Benchmark

*Inception Date: 6/30/1992. CFA Institute compliant. Net of fees.



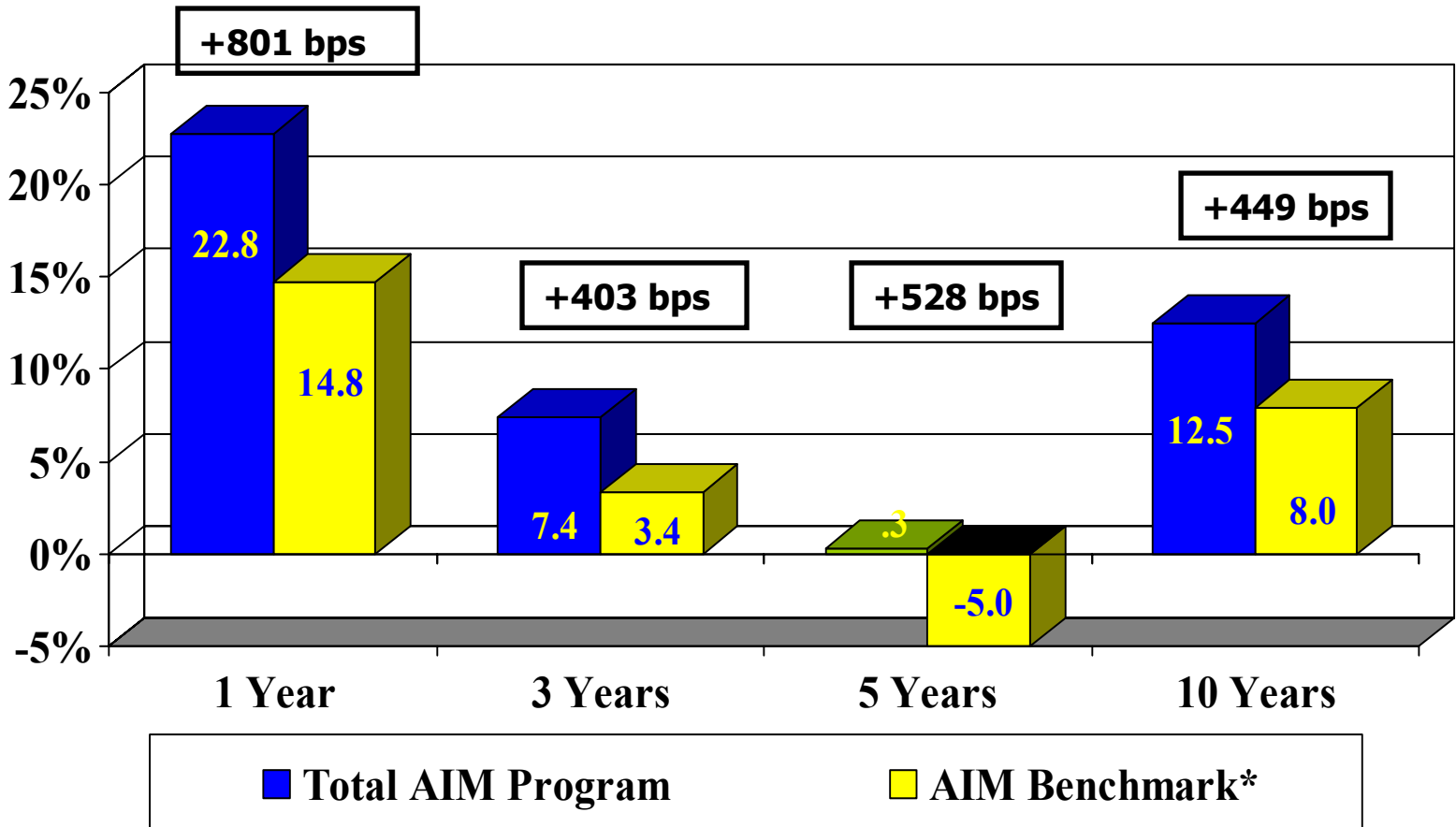
Global Fixed Income Annualized Active Return in Basis Points Ending 6/30/05

(Current Assets of \$48 Billion)



Source: SSB Net of Fees

AIM Program Active Return in Basis Points as of 6/30/05 (*Current Assets of \$9.2 Billion*)

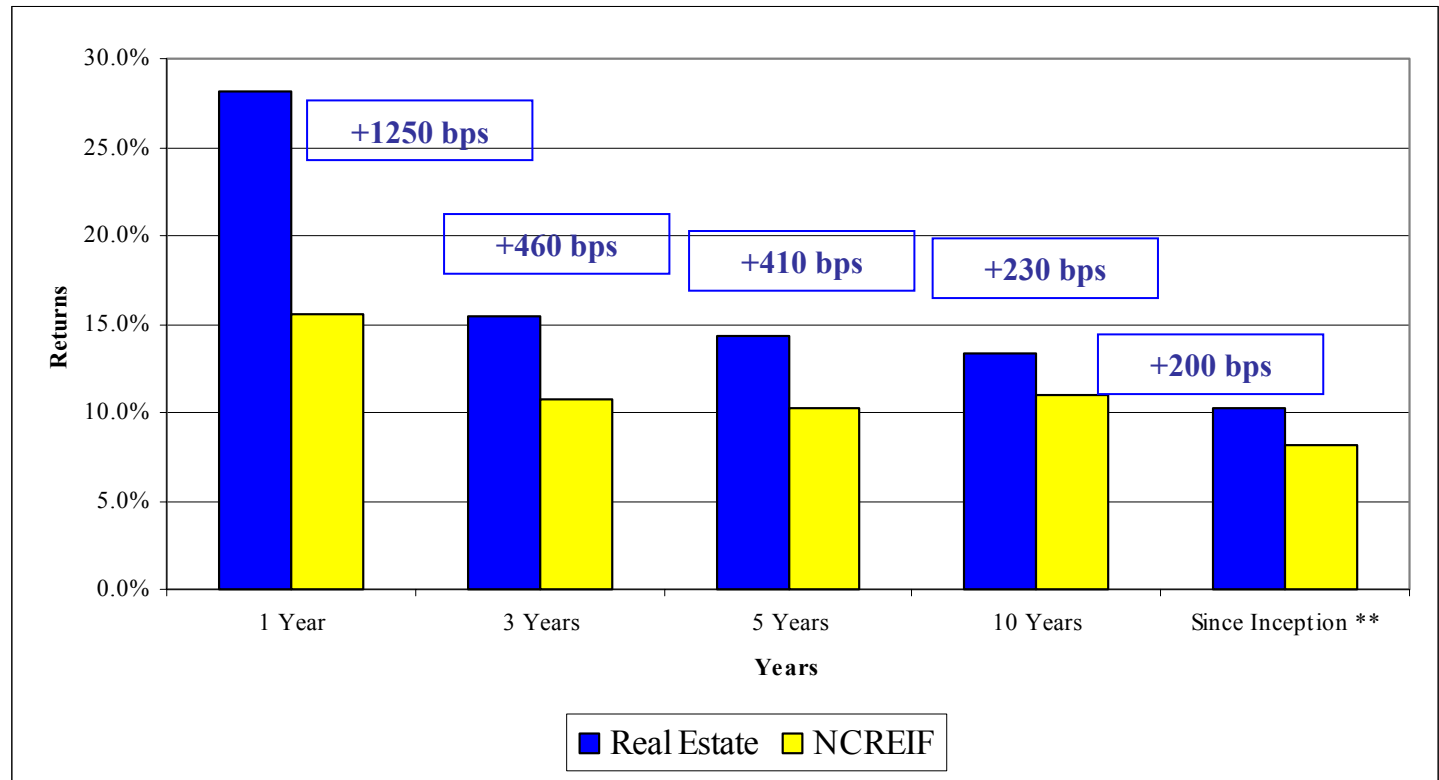


*AIM Benchmark is the blended Venture Economics Custom Young Fund Universe/Wilshire 2500 + 500 bps

Performance is net of fees.

Real Estate Annualized Active Return in Basis Points as of 3/31/05 (After Fees)* (Current Assets of \$ 10.9 Billion)

Real Estate continues to outperform the NCREIF Index



* Total Real Estate is after fees, however NCREIF benchmark is before fees, therefore not a like comparison

** Since Inception date was June, 1982

Key Accomplishments

- Operations
 - Developed a database to enable the Investment Office to track and report on the diversity within its investment programs.
 - Streamlined the material content in the Investment Committee binder.
 - Completed a successful General Pension Consultant RFP and Interview process.
- Risk Management
 - Completed a complex and challenging 3 year Risk Measurement Enhancement project on time and under budget.
 - Conducted a successful Asset/Liability Workshop.
 - Successfully implemented a revised Strategic Asset Allocation.
- Fixed Income
 - Successfully implemented an emerging debt investment policy.
 - Made the first credit enhancements through use of CalPERS' AAA rating.
 - Generated a significant increase in securities lending revenue.

Key Accomplishments, Continued

- AIM
 - Reached \$7 billion in realized cash profits since Program inception.
 - Produced the pre-eminent investment conference on Clean Technology
 - Maintained continuity and cohesion through AIM leadership transition.
- Global Equity
 - Developed internal capability for international equity management.
 - Implemented a resource pool for Corporate Governance.
 - Initiated CalPERS' first ever Environmental RFP.
- Real Estate
 - Locked in attractive gains (35% return) through \$6 billion of portfolio sales.
 - Allocated \$2.8 billion in new capital to Opportunistic and International Real Estate.
 - Strengthened the Responsible Contractor Policy.

Enterprise Goal I

- “Exercise global leadership to ensure the sustainability of CalPERS’ pension and health benefit systems.”
 - Commitment to Diversity
 - Long term portfolio and investment outlook
 - Leadership in Corporate Governance

Commitment to Diversity

- Develop and begin implementation of comprehensive and focused diversity plan, including increased outreach to emerging financial service providers
 - Partner with CalSTRS to develop comprehensive data base of emerging financial service providers
 - Design and conduct Board Workshop on diversity in the financial industry (November 2005)
 - Sponsor conference in Spring 2006, with focus on emerging financial service providers

Long Term Investment Outlook

- In managing CalPERS' portfolio, the Investment Staff will look to the horizon and not to the calendar.
- We will seek investment opportunities where long term, ***patient*** capital can be best rewarded.
 - Private equity and venture capital
 - Non Core Real Estate
 - Absolute Return Strategies
 - Corporate Governance Investments
 - International and high yield bond markets

Corporate Governance and CalPERS Global Leadership

- Continue to exercise Global leadership in corporate governance.
- Ensure integrity of financial statements thru regulatory engagement (SEC, PCAOB, etc.)
- Improve transparency of environmental impact disclosure
- Move executive compensation to pay for performance
- Advance the rights of shareowners (majority vote, proxy access, etc)
- Further ownership interest through active management

Strategic Goal VIII

Asset and Liability Management

- “Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.”
 - Manage both ***risk*** and return
 - Impact on Asset Allocation policies

Managing both Risk and Return

- CalPERS' Pension Fund Risk Management System (PFRMS) is now fully functional.
 - Macro Risk Control: We now track the risk/return ratio across all asset classes to ensure that the risk underwritten by CalPERS' investment capital is properly rewarded with a commensurate rate of return.
 - Micro Risk Control: We now track Information Ratios across all asset classes to ensure that the risk undertaken by CalPERS' Investment Staff is properly rewarded with excess returns.
 - PFRMS will be available to all portfolio managers through CalPERS' Intranet.

Impact of Risk on Asset Allocation Policies

- CalPERS' Decision factors are now evenly balanced between taking more return versus reducing the volatility of employer contributions.
- CalPERS Asset Allocation workshop specifically incorporated an Employer panel discussion to assess the volatility of employer contributions on their business operations.
- CalPERS has revised its investment policies with respect to its equity index fund management to expressly allow for hedging techniques to dampen the volatility of returns associated with the equity markets.
- CalPERS will continue to address the risk of the fund and volatility of returns within the context of the pension fund debate.

Strategic Goal IX

Asset and Liability Management

- “Achieve long-term, sustainable, risk adjusted returns.”
 - Recognize Capacity Constraints in Generating Excess Returns
 - Apply Creativity to Seek Opportunistic Sources of Return
 - Maintain our Commitment to Competency in Staff Development and Retention

Capacity Constraints Impact Every Part of CalPERS Portfolio

- AIM:
 - There is more competition today than ever to get into the top quartile funds.
 - Top quartile funds are **all** over subscribed.
 - The AIM Strategic review will review the issue of excess top quartile demand.
- Real Estate
 - A flood of money into Core real estate has driven capitalization rates down to historic lows.
 - Better opportunities lie in the Non-Core side of the Real Estate market.
- Global Equity
 - The sheer size of Global Equity--\$125 billion—requires continued diligence to find the best investment opportunities.
 - Absolute return strategies, risk-controlled net long strategies where the long-only constraint is relaxed, and corporate governance funds offer capacity plus excess return potential.
- Fixed Income
 - The US fixed income market is the most liquid in the world.
 - Excess return opportunities may need to be sought in high yield, international bonds, and collateralized debt obligations.

Seeking Creative Investment Opportunities

- In general, asset class distinctions will blur as “Cross Over” Strategies are pursued in the quest for greater returns:
 - Hedge funds competing against private equity firms in bidding for public companies.
 - Private equity firms starting hedge fund groups.
 - More Real Estate opportunities in commingled funds.
 - Private equity firms pursuing Governance Strategies.
- Examples of Recent Creative Investment Opportunities
 - AIM implementation of the \$200 Clean Technology Program.
 - Real Estate shifting towards Non-Core investments—currently at 39% of the Real Estate Portfolio and growing.
 - Global Equity establishment of a \$500 million Development Fund to incubate new investment strategies.
 - Fixed Income implementation of a \$2 billion emerging debt policy.
 - A joint \$325 million investment by the AIM team and the Governance Team in Blum Capital Partners, a cross over fund.

Commitment to Competency

- The CalPERS Investment Staff is Committed to Professional Competency.
- We have one of the best trained Investment Staffs in the world.
- We must continue our Commitment to Competency through Staff development and retention.

Scorecard of Competency

- CFA Charterholders: 33
- CFA Candidates: 30
- MBAs: 41
- PhDs: 3
- JDs: 6
- CPAs: 10
- NASD Securities Licenses: 5
- Toigo Foundation and Other Scholars: 2

Some Key Objectives for 2005-2006

- Global Equity
 - Complete the Environmental RFP and allocate capital to green managers.
- AIM
 - Complete the Strategic Review of the AIM Program.
- Fixed Income
 - Produce Excess returns in a rising interest rate environment.
- Real Estate
 - Shift the portfolio to a 50-50 split between Core and Non Core investments.
- Risk Management
 - Roll out in stages to the Investment Staff the Risk Management System using CalPERS' intranet.
- Operations
 - Conduct a Diversity Workshop for Investments.

Next Steps

- Presentation of the business plan/asset class review for each unit within the investment Office:
 - Global Equity and Global Fixed Income in October
 - Private Equity and Real Estate in November
 - Investment Operations and Risk Management in December
- Receive input from the Board and re-calibrate the Investment Office Annual Plan as necessary.
- Synchronization of the Investment Office Annual Plan with the CalPERS Enterprise Wide Business Planning Process.